What Superannuation Funds Want to know about Private Equity … and What Private Equity Managers Want to Tell Them

Absolute Returns Funds 2008 Conference

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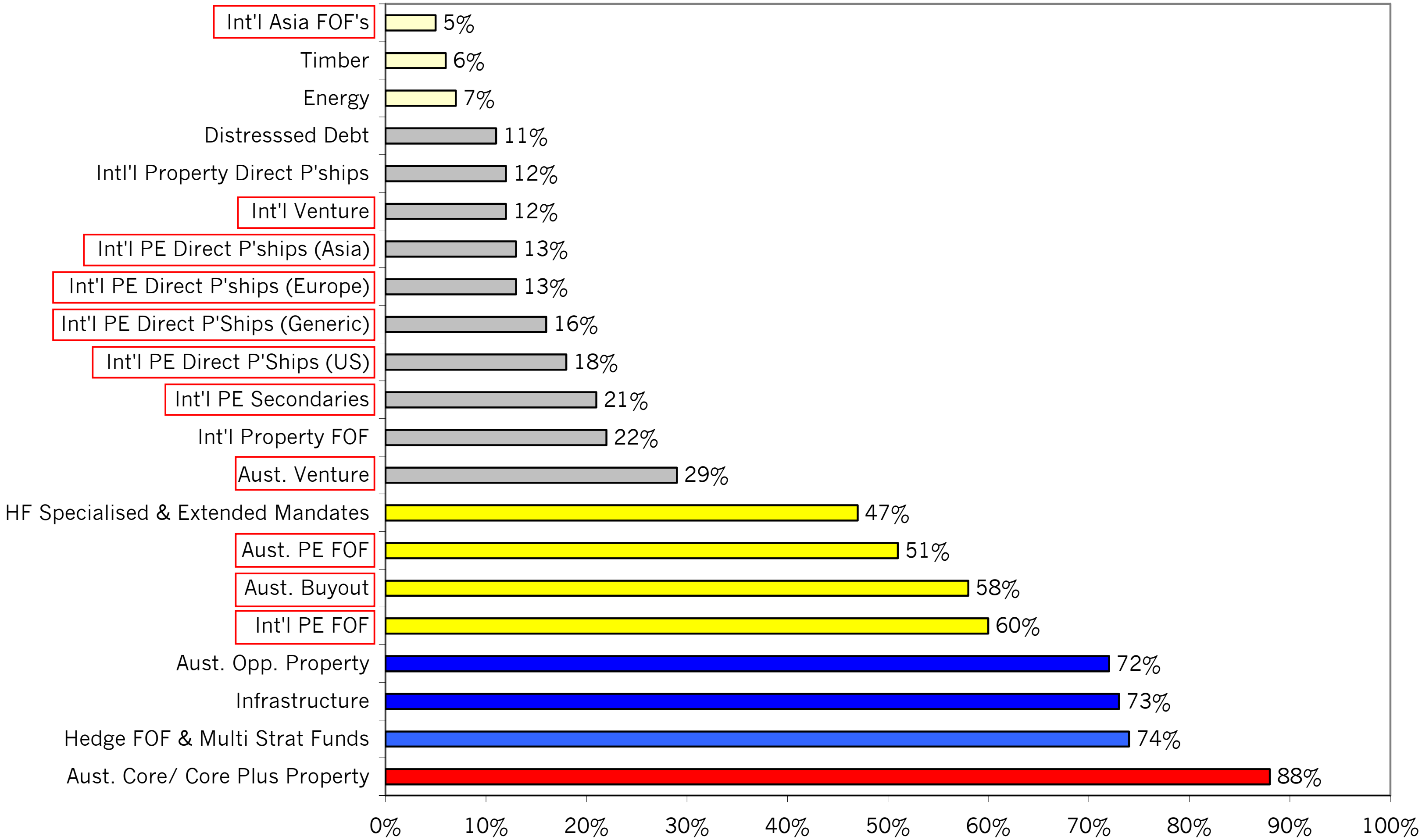
alternative investment placement

Agenda

- Australian superannuation fund preferences in private equity
- Beliefs and perceptions that are shaping strategy
- Relationship between Australian investors (*the Limited Partners or LPs*) and private equity funds managers (*the General Partners or GPs*)

.... There will be messages for investors and private equity fund managers

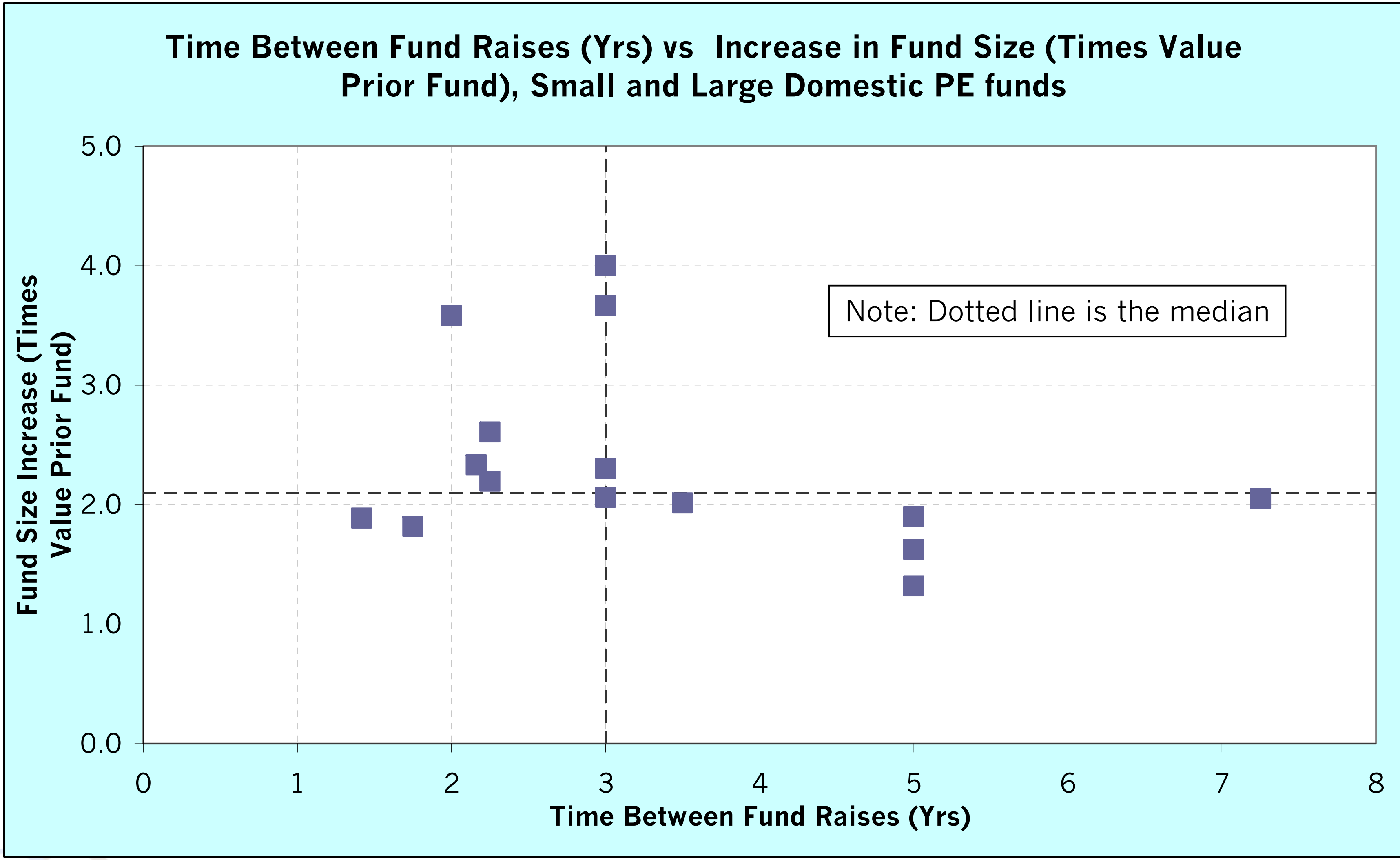
Larger Australian Superannuation Funds invested by key category (as at Jun-08; by AUM)[1]



Note 1: Based on a publicly available information on a sample of the approx. 60+ superannuation funds in Aust. & NZ with alternative investment exposure, subject to inaccuracies, errors in interpretation, incomplete disclosure and mistakes

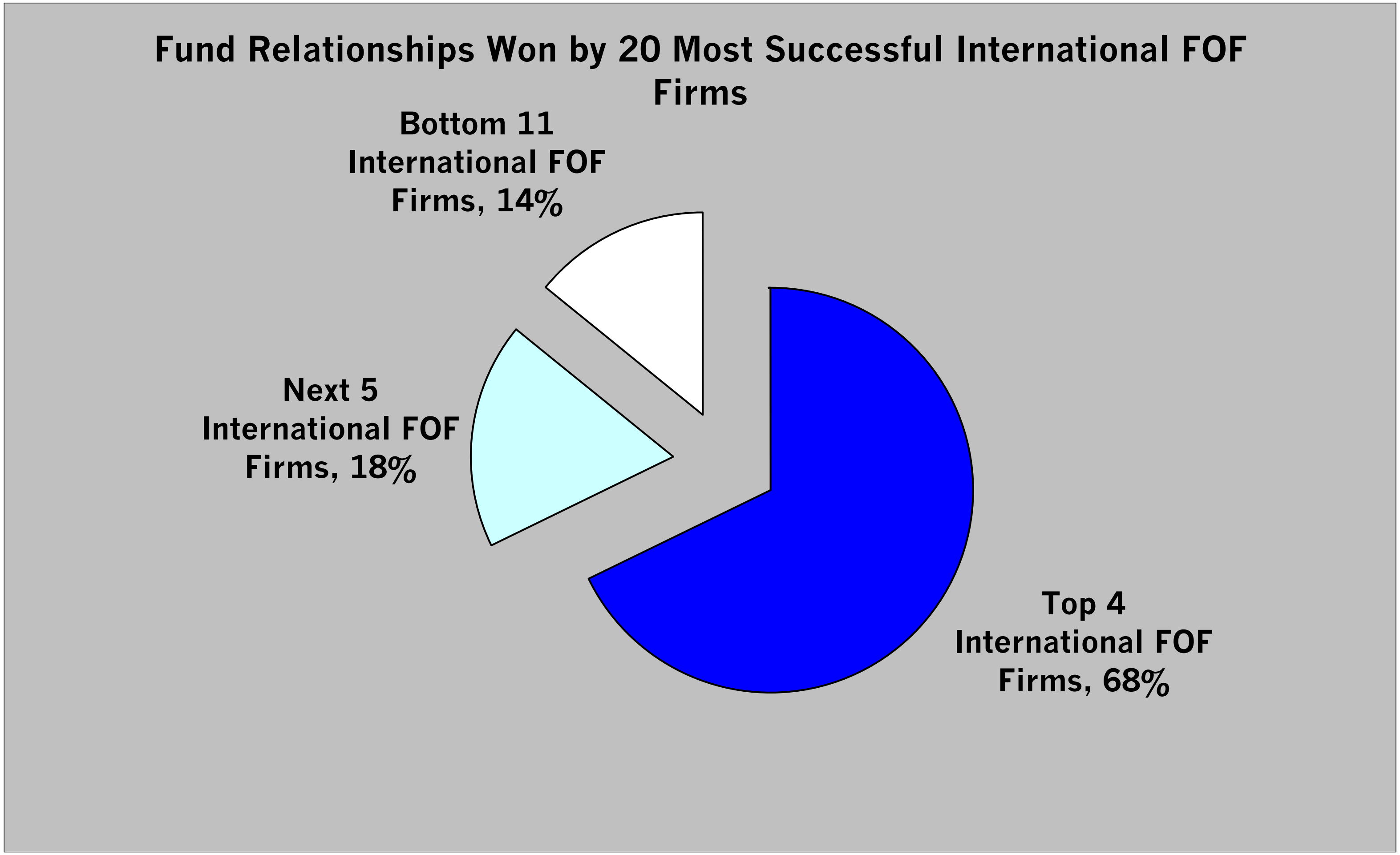
Note 2: Exposure to Venture, Secondaries and Asia FOFs likely understated given exposure via broader FOF programs and relationships not attributed correctly

Preferences: Australian buy-out investments



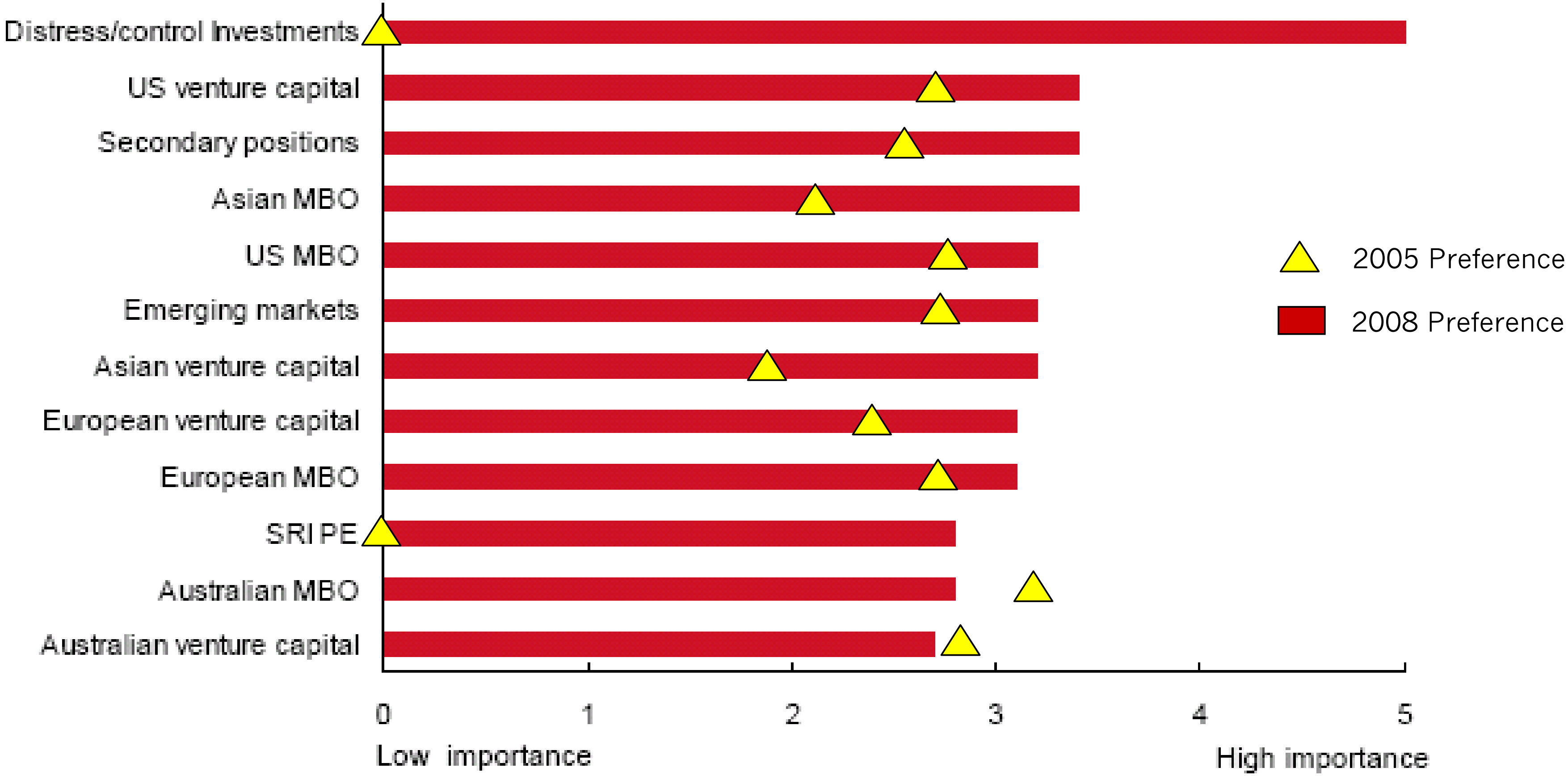
Note 1: Based on a publicly available information of a sample of leading Australian buyout funds who have attracted primary support from Australian superannuation funds, and whose last fund size exceeded $100m

Preferences: International FOF investments



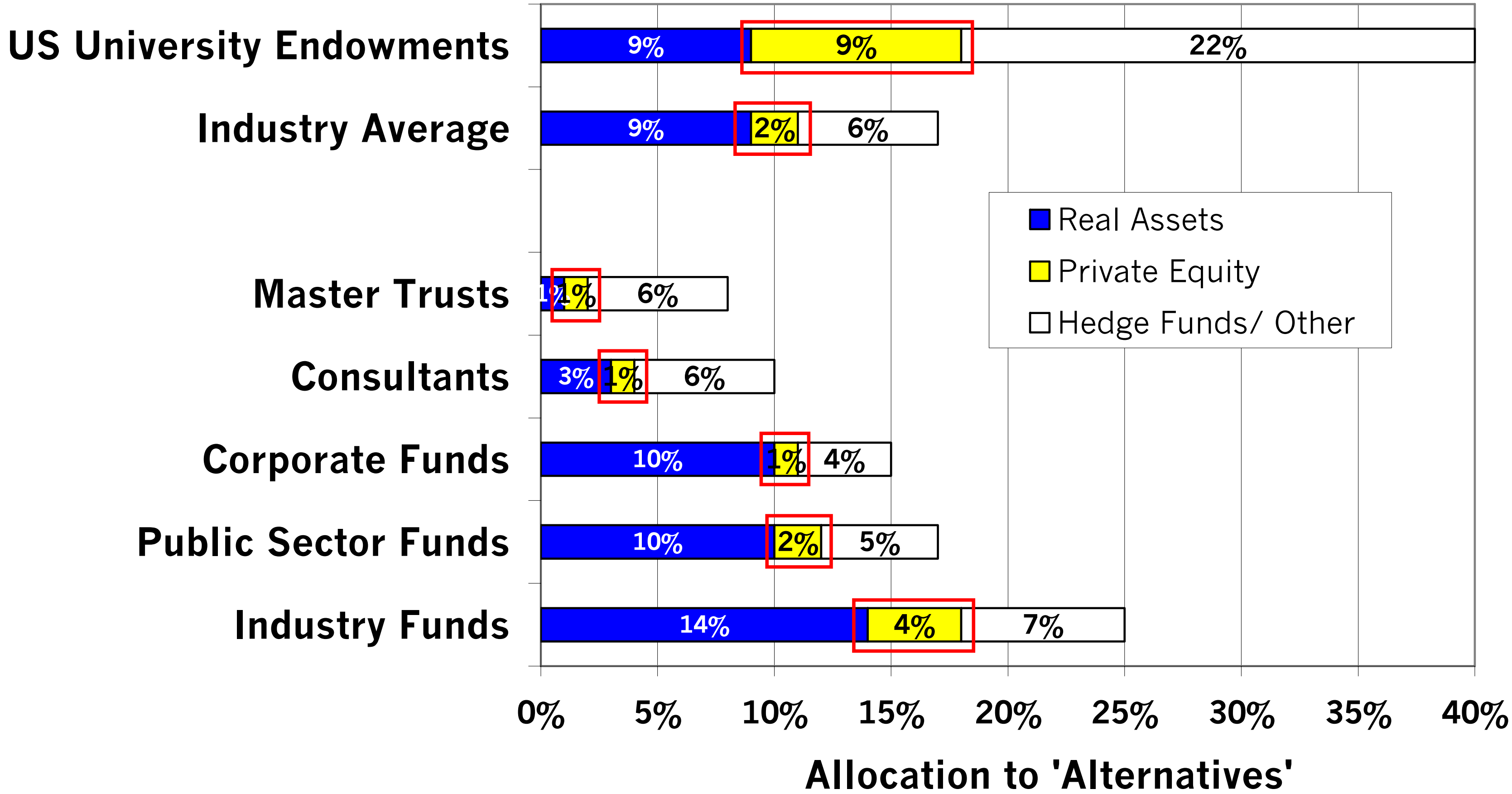
Note 1: Australian Superannuation Fund relationships won by managers of broad-based international private equity fund of funds (incl. Europe, Nth American and Asian focussed funds), based on publicly available information as of 30 June 2008

How have Private Equity preferences changed over the past few years?



Note 1: Most attractive private equity segments over the next 2 to 5 years
Source: John Evans, Study of Australian Superannuation Fund Attitudes to Private Equity Investing, The University of New South Wales Australian School of Business, Australian School of Business Research Paper, May 2005, April 2008. Slide is an approximation of findings.

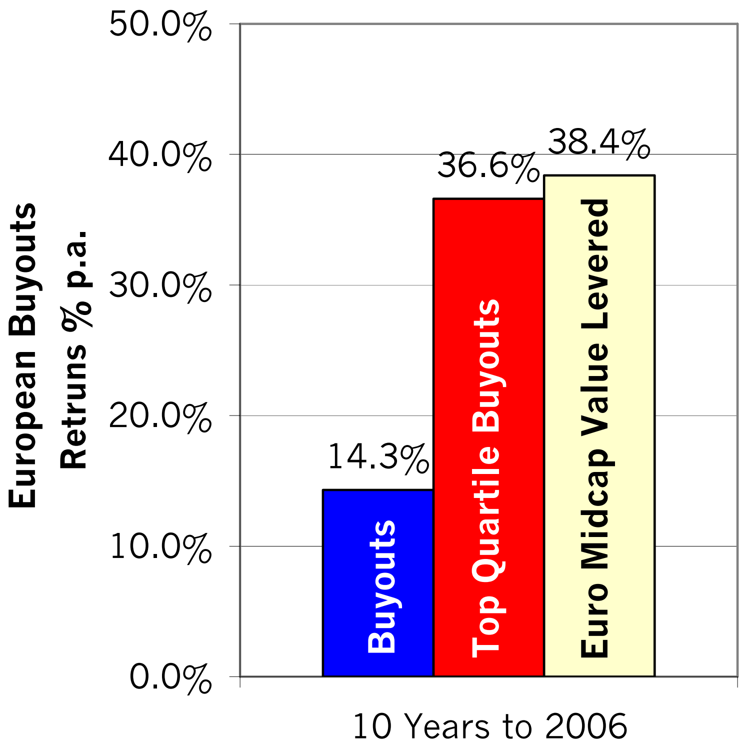
Superannuation fund allocations to private equity[1,2,3,4]



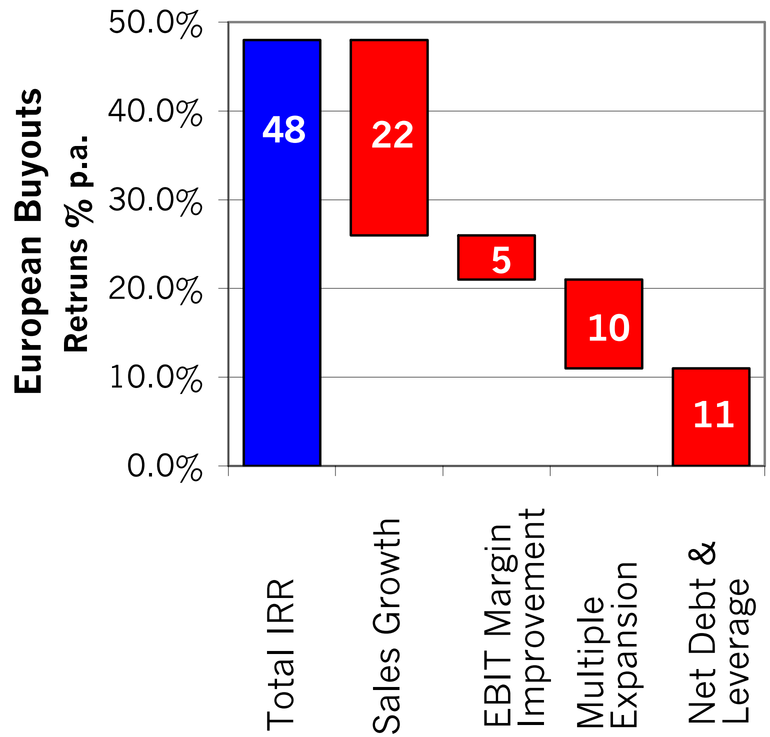
Note 1: Australia data from Chant West, Multi-Manager Survey, June 2008, Vol. 5, No. 4. Based on a survey of the SAAs of 50+ major superannuation fund “growth options”, with 61% to 80% growth assets; includes core and core plus property
Note 2: Average US University Endowment Data for endowments greater than $1bn, from NACUBO Endowment Study 2006
Note 3: Real Assets for Australian funds includes property and infrastructure only.
Note 4: Real Assets for US Endowments includes property, infrastructure, commodities, timber and oil/ gas.

1. Scepticism – Is it leverage or value adding?

"Adjusted" returns versus listed market comparables?[1]



Leverage, rising asset prices or fundamental value creation?[2]



Note 1: Citigroup Global Markets Research, European Portfolio Strategist, November 2006. See slide 23 for further detail.

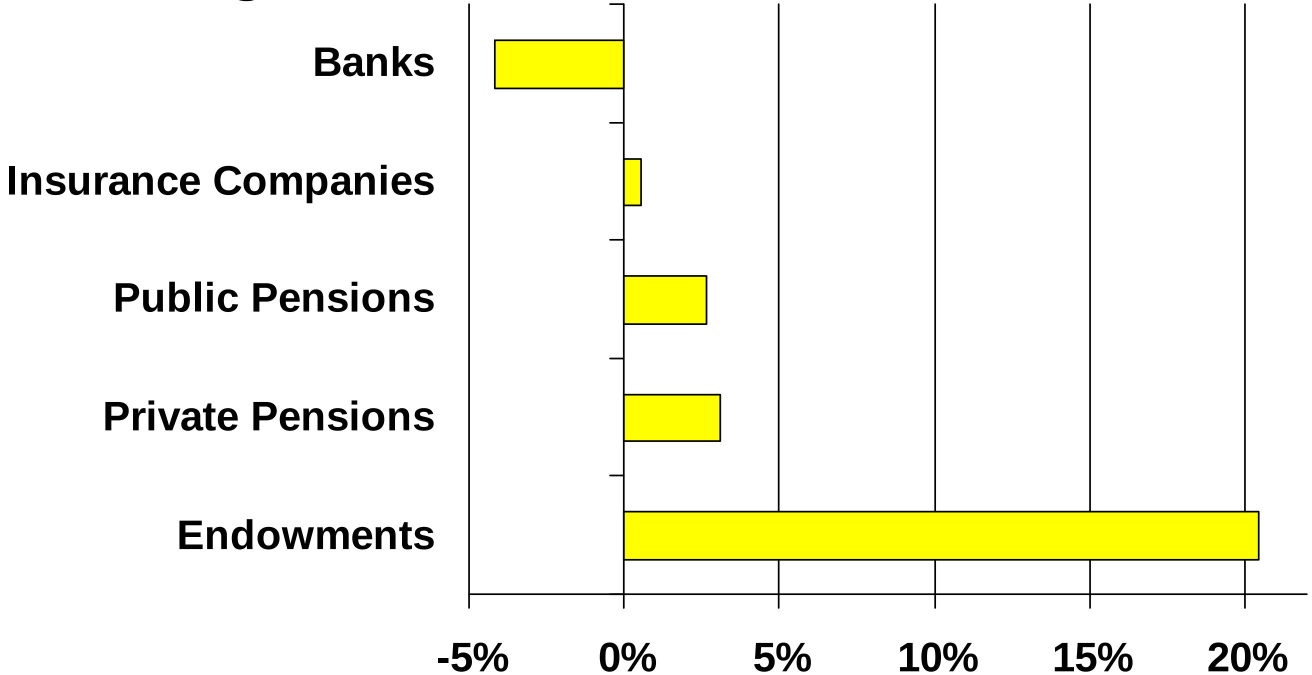
Note 2: Boston Consulting Group, Based on a Sample of 32 European Portfolio Companies, February 2008. See slide 23 for further detail.

5 reasons why PE allocations are modest? .... continued

2. Liquidity mis-match?
3. Fee model & the “twin conundrums” – J-Curve and Sizing?
4. Poor vintage year experience early in the program?

5. Are good results realistically achievable?

IRR Performance of US Limited Partner Private Equity Programs by Investor Group 1991 – 2001 Vintage Years



Source: Chart from Lerner, J. "Private Equity Boom or Bust?", 2004 AVCAL Presentation, based on data from Josh Lerner, Antoinette Schoar and Wan Wong (2005), "Smart Institutions, Foolish Choices?: The Limited Partner Performance Puzzle", Harvard University, NBER.

Principles of the investor – GP engagement

1. Hire and retain talented individuals to take risk and maximise returns for investors
2. It's a "**Partnership**" – investors and GPs should be guardians of that objective
3. GP creates substantial wealth from:
   a) Their own investment in the fund
   b) A carried interest fairly linked to investor success

5 key investor questions at the starting block

1. Distinctive capabilities – and the “secret sauce”?
2. Is there firm evidence of success as a team:
   - IRR <u>and</u> Times Money?
   - Fundamental value creation?
3. Backed by other leading LPs?
4. FUM capacity & resource loads?
5. Right dynamics and structures?

Let’s talk terms: What builds and degrades an investor’s sense of alignment?

Behaviour that polarises investors and GPs?

- From the investor's perspective:
  1. Prickly engagement around the detail i.e. budgets
  2. Scale back in later funds
  3. Style of engagement – failure to "make every touch a good one"
  4. "Cold shoulder" in response to a "no"
  5. Unflagged changes

Information the investors want, but the GP's aren't always good at providing

- Underperforming deals
- Succession and alignment across team "generations"
- Softer aspects of the business –
  - Culture
  - Disgruntlements
  - Biases and prejudices
  - Tensions in the firm

  Etc

Behaviour that polarises investors and GPs

- From the GP's perspective:
  1. Hard negotiations on inconsequential issues & on terms with managers in their formative days
  2. Poor discipline and guidance throughout the fund raising process and fund investment period

     i.e. Significantly incorrect guidance on levels of interest in a new fund

     Lack of feedback as to issues and concerns

     Lack of continuity in the engagement, frequent changes in personnel

     Disclosure of sensitive information

Guidance to investors:
(1) The fund raising response that GPs want

1. Quick YES
2. Quick NO
3. Slow YES
4. Slow NO

(2) The engagement GPs prefer?

- Strategic sounding board – fund & portfolio company strategy
- Papers on best practice
- Feedback on strengths and weaknesses
- GP to GP linkages
- Investor referrals

(3) How to improve an allocation position

- Are you an existing investor?
- Type of investor
- "Quality" of relationship
- Fit with manager
- Knowledge of the asset class
- Stability of personnel
- Strong endorsement from existing investors
- $$$

Elements of a successful approach by investors

- Steadily broadened exposure and built up allocations — and expertise
- Always "in the market"
- Senior most team at the front end of dealing with GPs
- Open and constructive relationship with managers
- Emphasis on being a trusted and valued partner for GPs
- Leverage best relationships for information, co-investment
- Leverage "non-public" information, stakeholders & peer group to make decisions
- Mix of proven and emerging managers — "toe hold" concept
- Allocate with conviction
- "On the road, wearing out the shoe leather"

The role of placement?

An end-to-end solution starting with concept design through to fund raising and investor relations:

- Bring 1st rate managers to Australia and take 1st rate Australian managers offshore — and support the development of emerging Australian managers
- Gain access to “out-of-the-box” opportunities
- Re-shape the presentation of the investment offer and other aspects of the offer to better suit Australian investors
- Elevate aspects of the offer to best local practice
- Lower the risk of a capital raise — and limit time wasting for all parties
- Invest side by side with other investors

Brookvine was established in 2001 as an independent marketing specialist in alternative investments. We work with a small number of exceptional Fund managers each year to help them raise institutional investment capital and build strong business franchises.

Our services range from the development of an initial fund proposition, through to raising investment capital and the management on-going investor relationships.

To date, we have raised over $6 billion for our investment partners.

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Notes

References:

1. “The Advantage of Persistence: How the Best Private Equity Firms Beat the Fade”, Boston Consulting Group and The IESE Business School of Navarra (2008)
2. “Smart Institutions, Foolish Choices?: The Limited Partner Performance Puzzle”, Josh Lerner, Antoinette Schoar and Wan Wong (2005), Harvard University, NBER
3. “Private Equity Performance: Returns, Persistence and Capital Flows”, Steve Kaplan, University of Chicago, and Antoinette Schoar, MIT (2004)
4. NACUBO Endowment Study (2006)
5. FLAG Capital Management, LLC, “The Commitment Conundrum”, Insights (January 2008)
6. Chant West, Multi-Manager Survey, June 2008, Vol. 5, No. 4.
7. “Pan-Europe/UK — How Do they Do That?”, “European Portfolio Strategist, Citigroup Investment Research (November 2006)
8. “Study of Australian Superannuation Fund Attitudes to Private Equity Investing”, John Evans,The University of New South Wales Australian School of Business, Australian School of Business Research Papers (May 2005, April 2008)

Notes to Slide 8:

1. Chart titled “Adjusted returns versus listed market comparables?” sourced from “European Portfolio Strategist, Citigroup Investment Research (2006) and based on an analysis that compares European buyout returns with a universe of European mid-cap stocks selected by Citigroup as a sample that is comparable to the buyout portfolio company universe, with an adjustment made to equate the degree of leverage, so that the combined underlying company and portfolio leverage produces a total debt/equity exposure of 75%/25%.

2. Chart titled “Leverage, rising asset prices or fundamental value creation?” sourced from “The Advantage of Persistence: How the Best Private Equity Firms Beat the Fade”, Boston Consulting Group and The IESE Business School of Navarra (2008) and based on an internal Boston Consulting Group study of 32 portfolio companies of 7 leading European buyout firms.